***JT USA LP v. Commissioner, 131 T. C. 59 (U. S. Tax Court 2008)***

In JT USA LP v. Commissioner, the U. S. Tax Court ruled that partners can make different elections under the Tax Equity and Fiscal Responsibility Act (TEFRA) for different partnership interests they hold. This decision allows partners to opt out of partnership-level proceedings for specific interests, impacting how the IRS conducts audits and resolves tax disputes involving partnerships. The ruling clarifies the rights of partners in complex partnership structures and emphasizes the need for proper notification from the IRS.

**Parties**

Plaintiffs: JT USA LP, John Ross, and Rita Gregory, identified as partners other than the tax matters partner (TMP) at the trial level. Defendants: Commissioner of Internal Revenue, respondent throughout the litigation.

**Facts**

John and Rita Gregory founded JT USA LP, which sold motocross and paintball accessories. In 2000, they sold the business assets for $32 million, triggering a significant capital gain. To offset this gain, they engaged in a tax shelter known as a Son-of-BOSS transaction. This involved restructuring the partnership's ownership, including creating indirect partnership interests through JT Racing, LLC (JTR-LLC) and JT Racing, Inc. (JTR-Inc. ). The IRS issued a Notice of Final Partnership Administrative Adjustment (FPAA) challenging the tax shelter, but failed to send the required initial notice under section 6223(a) of the Internal Revenue Code. The Gregorys attempted to elect out of the TEFRA proceedings only in their capacity as indirect partners.

**Procedural History**

The IRS issued the FPAA to JT USA LP and its partners in October 2004. The Gregorys responded with elections to treat their partnership items as nonpartnership items as indirect partners, while electing to remain in as direct partners. They filed a petition with the U. S. Tax Court in March 2005. In November 2006, the Gregorys moved to strike themselves as indirect partners from the case and requested that JTR-LLC be substituted as the petitioner. The Tax Court held oral arguments and considered the validity of the Gregorys' elections and the proper parties to the proceeding.

**Issue(s)**

Whether partners holding different interests in the same partnership can make different elections under section 6223 of the Internal Revenue Code for each interest? Whether the Gregorys' elections to opt out of TEFRA proceedings as indirect partners were effective?

**Rule(s) of Law**

Section 6223 of the Internal Revenue Code and section 301. 6223(e)-2T(c) of the Temporary Procedural and Administrative Regulations govern the election process for partners to opt out of TEFRA partnership-level proceedings. The regulations require that an election be made within 45 days of the FPAA mailing and include specific information and a signature. The election applies to all partnership items for the relevant tax year.

**Holding**

The Tax Court held that partners can make different elections under section 6223 for each partnership interest they hold. The court ruled that the Gregorys' elections to opt out as indirect partners were effective, as they met the regulatory requirements, and the limitation to their capacity as indirect partners was permissible.

**Reasoning**

The court's reasoning centered on the interpretation of the term "partner" under TEFRA and the regulations, finding that it refers to a person holding a specific partnership interest, not all interests held by that person. The court noted that the regulations allow for different treatment of partnership items based on different interests held by the same person, as evidenced by examples in the regulations. The court also considered state partnership law, which recognizes dual capacities within partnerships. The court rejected the IRS's argument that allowing different elections would increase administrative burden or lead to inconsistent results, noting that such inconsistency is inherent in tiered partnerships. The court also addressed the incorrect notice sent by the IRS, which did not affect the validity of the Gregorys' elections. The court further held that the Gregorys' elections to "opt in" as direct partners were unnecessary, as the default rule under section 6223(e)(3) already bound them to the proceedings in that capacity.

**Disposition**

The court granted the Gregorys' motion to strike them from the case as indirect partners and allowed JTR-LLC, the tax matters partner, to intervene and continue the proceedings.

**Significance/Impact**

This decision clarifies the rights of partners in complex partnership structures under TEFRA, allowing them to make different elections for different interests. It emphasizes the importance of proper IRS notification and the potential consequences of procedural errors. The ruling may affect how the IRS conducts audits and resolves disputes involving partnerships, particularly those with tiered structures. It also underscores the need for clear regulatory guidance on partner elections and the treatment of different partnership interests.

 